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Ms. Magalie Roman Salas
Secretary
Federal Communications Commission
445 Twelfth Street, SW
Washington, DC 20554

DOCKET FILE COPY ORIGINAL

Re: 2000 Biennial Regulatory Review – Comprehensive Review of the Accounting Requirements and ARMIS Reporting Requirements for Incumbent Local Exchange Carriers: Phase 2 and Phase 3 (CC Docket No. 00-199)

Dear Ms. Salas:

AT&T Corp. ("AT&T") submits this letter to emphasize that the proponents of repealing the Commission's accounting and reporting rules have not satisfied the statutory standards for repeal set forth in Section 11 of the Communications Act. 47 U.S.C. § 161. There is no meaningful economic competition that would justify repeal of all or part of the Commission's accounting and reporting rules. To the contrary, repeal would only undermine efforts to promote competition.

1. Congress required the Commission to initiate this biennial review for a single purpose: to determine whether "meaningful economic competition" has rendered any of the Commission's accounting rules "no longer necessary in the public interest." 47 U.S.C. § 161(a). Not a single commenter has even attempted to make such a showing. The incumbent LECs, who are the *only* proponents of repeal, have submitted no evidence that "meaningful economic competition" exists in the relevant markets – *i.e.*, local and access markets nationwide. Nor could they. The incumbent LECs are dominant carriers with market power throughout their regions, and they indisputably continue to control the vast majority of the nation's access lines. Moreover, competitive LECs nationwide are collapsing, and many new entrants are now either in or on the brink of bankruptcy. No party could seriously assert that there is "meaningful" economic competition that would permit repeal of all or part of the Commission's accounting and reporting rules, and there is no basis to make such a finding on the record developed in these proceedings.

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The Commission is not free to ignore the statute. Indeed, Section 11's standard for repeal is at least as stringent as Section 10's three-pronged test for forbearance. *See* 47 U.S.C. § 160(a) & (b). Section 11 involves the repeal or modification of a rule – for all carriers, for all services, in all geographic areas, for all purposes. Because Section 11 has such far-reaching consequences, Congress directed the Commission to repeal a rule only where it found that meaningful economic competition, on an industry-wide basis, has rendered that rule unnecessary for any purpose.

Broad repeal or modification of the Commission's accounting and reporting rules would also be inconsistent with the purpose of Section 11. In enacting Section 11, Congress did not envision a wholesale elimination of the Commission's rules in these first years after passage of the Act. To the contrary, the only purpose of Section 11 is to prevent truly outdated rules from remaining in force purely through agency inertia. The statute requires the Commission to *consider* repeal every two years, but Section 11 in no way prejudges the outcome of that process. To the contrary, by its express terms the statute contemplates repeal only *after* meaningful competition has developed. That day has not yet arrived. Indeed, even apart from the dictates of Section 11, the Commission should not be repealing rules that were adopted to protect consumer interests without a finding – that could not be made on this record – that significantly changed market circumstances have rendered the rules unnecessary to protect the public interest. Accordingly, the Commission should retain its accounting and reporting rules for the time being, in accordance with the Commission's earlier observations that these rules are necessary to monitor incumbent LECs as competition develops in local markets.[1]

2. Equally important, the comments overwhelmingly demonstrate that retention of Class A accounting requirements is essential to the eventual development of "meaningful economic competition." Enforcement of the Commission's (and the state commissions') regulatory programs depends on the availability of *information* – information about the networks and costs of the dominant incumbent LECs. Not only does the Commission rely on this information in numerous regulatory contexts, but the commenting state commissions unanimously showed that they also rely heavily on the

[1] *In the Matters of 1998 Biennial Regulatory Review – Review of Accounting and Cost Allocation Requirements*, Notice of Proposed Rulemaking, 13 FCC Rcd. 12973,¶ 6 (June 17, 1998) ("For the largest incumbent LECs, however, our review of these rules indicates that we should maintain the level of detail required by Class A accounting. We believe that the more detailed Class A accounting is required to monitor the large incumbent LECs *as competition begins to develop in local telephony markets*. The more detailed accounting requirements are also necessary for the Commission to uphold our statutory obligations under sections 254(k), 260, 271, 272, 273, 274, 275, and 276 of the Act. Class A accounting is necessary to ensure that the largest incumbent LECs are in compliance with these provisions, such as section 254(k)'s mandate that "a telecommunications carrier may not use services that are not competitive to subsidize services that are subject to competition." The level of detail of the Class A accounting rules allows us to identify potential cost misallocations beyond those revealed by the Class B system of accounts.") (emphasis added).

information provided by the Commission's nationally uniform Class A accounting and ARMIS reporting rules. Substantial repeal or modification of Class A reporting requirements would be unique in that it would undermine a vast array of other Commission and state commissions regulatory programs.[2] The Commission should not lightly throw away these informational resources, especially when the state commissions that are instrumental in carrying out some of the market-opening provisions of the Communications Act unanimously oppose such repeal.

Both the Commission and the state commissions rely on Class A accounting detail in numerous contexts:

a. The Commission and especially the state commissions use Class A accounts in resolving pricing issues under Section 251. 47 U.S.C. § 251. For example, the Commission has established Total Element Long Run Incremental Cost (TELRIC) as the method for pricing unbundled network elements. In making TELRIC pricing determinations, many states use models similar to the one the Commission uses to determine universal service support, which rely on Class A accounts. Elimination of Class A detail would cripple state efforts to implement and enforce Section 251 at a time when such issues are becoming more important than ever.[3] Moreover, the Commission

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[2] *In the Matter of Implementation of the Telecommunications Act of 1996: Reform of Filing Requirements and Carrier Classifications*, Order and Notice of Proposed Rulemaking, 11 FCC Rcd. 11,716 (Sept. 12, 1996) (*Reform of Filing Requirements NPRM*) ("We believe that continuing to require ARMIS reports from those incumbent LECs for which annual operating revenues, both regulated and nonregulated, exceed a defined, inflation-adjusted threshold is necessary to provide us with the financial and operating date we need to administer our accounting, cost allocation, jurisdictional separations, and access charge rules, and to preserve our ability to monitor industry developments and quantify the effects of alternative regulatory proposals. Our ability to detect improper subsidization of nonregulated services in violation of our cost allocation rules, as also mandated by the 1996 Act, would be impaired by a reporting requirement threshold based solely on regulated revenues. . . . Because improper subsidization, resulting from an improper allocation of nonregulated costs, could present a serious problem where the nonregulated operations are large relative to the regulated operations, we tentatively conclude that our reporting requirements should continue to be based on total operating revenues."); *In the Matters of Implementation of the Telecommunications Act of 1996: Reform of Filing Requirements and Carrier Classifications*, Report and Order, 12 FCC Rcd. 8071, ¶ 58 n.135 (May 20, 1997) ("*Reform of Filing Requirements Report*") ("ARMIS reports have been a valuable source of cost information to the Commission in its evaluation of tariffs filed under rate-of-return regulation. Cost information from these reports has also played an important role in tariff investigations, certain rulemakings concerning cost issues, and in the evaluation of exogenous cost adjustments under the price cap rules (for example, in determining the cost effects of property transfers.").

[3] *In the Matter of 2000 Biennial Regulatory Review – Comprehensive Review of the Accounting Requirements and ARMIS Reporting Requirements for Incumbent Local*

itself may increasingly find itself arbitrating Section 251 pricing disputes – for example, in states such as Virginia that fail to arbitrate local interconnection agreements.[4]

b. The Commission uses historical cost accounts to establish rates for pole attachments under Sections 251 and 224. *See* 47 U.S.C. § 251, 224; *Implementation of Section 703(e) of the Telecommunications Act of 1996; Amendment of the Commission's Rules and Policies Governing Pole Attachments*, Report and Order, CS Docket No. 97-151, 13 FCC Rcd 6777 (1998); Report and Order, FCC 00-116 (rel. April 3, 2000); Consolidated Partial Order on Reconsideration, FCC 01-170 (rel. May 25, 2001).

c. The Commission also relies on Class A accounting detail in establishing the cost model for determining the size and distribution of universal service subsidies. Specifically, the Commission's cost model establishes support flows based on forward-looking network configurations. The Commission must therefore distinguish between digital switching investments and digital switching expenses. This disaggregation is not available in the Class B accounts. At present, the model uses plant-specific expenses computed from expense-to-investment ratios from the USOA Class A accounts. The investment data used comes from other sources (*e.g.*, contracts to purchase switches). *See Federal-State Joint Board on Universal Service; Forward-Looking Mechanism for High Cost Support for Non-Rural LECs*,, CC Docket No. 96-45, Tenth Report and Order, CC Docket Nos. 96-45 & 97-160, (rel. Nov. 2, 1999), *aff'd Qwest Corporation v. FCC*, No. 99-9546 (10th Cir. July 31, 2001). Economists also use Class A accounts to check the model outputs, and they rely especially on the Cable and Wire Facilities accounts that are only available in Class A.[5]

Exchange Carriers: Phase 2 and Phase 3, Notice of Proposed Rulemaking, 15 FCC Rcd. 20568, ¶ 19 (October 18, 2000) ("*Phase 2 and Phase 3 NPRM*") ("Class A accounting data may be used by the states on a comparative basis in state UNE pricing proceedings. . . . Part 32 organizes telecommunications costs in a manner that allows a logical mapping of these costs to telecommunications rate structures. Switching costs, for example, currently are tracked separately from transport costs under our Part 32 rules. This cost distinction permits the carriers' use of separate rate structures for switching and transport UNEs, thus facilitating the states' efforts to compare costs and rates for each UNE.").

[4] Similarly, the FCC may find itself arbitrating a local interconnection agreements involving the correct pricing for resale. Should it decide to base its decision on an avoided cost standard (e.g., looking at the costs avoided in wholesaling a service, rather than offering it retail), the FCC would likely need to evaluate avoided cost studies that depend upon Class A accounting. The Class B account would be 6620 - services, but the individual Class A accounts that sum to 6620 have different avoided cost percentages.

[5] *Phase 2 and Phase 3 NPRM*, 15 FCC Rcd. 20568, ¶ 8 ("USOA data also is currently used to calculate high cost support in the Universal Service Program. Under our universal service rules, the cost basis used in determining high cost support for rural carriers differs from that used for non-rural carriers. Both approaches, however, rely on our uniform system of accounts.").

d. Class A accounts are also necessary for depreciation rate setting. The FCC and the states share the responsibility of setting depreciation rates used in ratemaking, although the states are free to establish a rate different than the federal one. Depreciation rates are significant because the size of the depreciation expense item greatly influences a company's reported earnings. Critical to the depreciation process is the ability to gain access to Class A level plant accounts, along with the retirement data that is contained in subsidiary records for those Class A accounts. If the Commission eliminates Class A accounts, all of this data would need to be recreated each time depreciation rates are reviewed (once every three years).

e. Class A accounts are also necessary to understand low-end adjustments under the Commission's price cap system. Price cap LECs (other than those who have gained and exercise pricing flexibility) are entitled to a rate increase if their earnings fell below 10.25% the previous year. Class A accounting is necessary to understand why the LEC's earnings are below 10.25% – for example, whether a particular expense category has spiked in a particular study area, and how that compares to the rest of the company or other companies. Without this information, the Commission has no ability to see any detail behind what might have produced a low earnings. As the Commission has explained, USOA accounts are also used to determine exogenous adjustments and to support above cap filings by price cap LECs, *Phase 2 and Phase 3 NPRM, 15 FCC Rcd. 20568,* ¶ 7, and the Class A level of accounting detail permits proper scrutiny of these types of upward price adjustments.

f. As the BOCs enter nonregulated lines of business, the Joint and Common Cost rules require an account by account allocation of nonregulated activities. This ensures that the FCC has the sufficient information about how regulated costs are affected. Class B accounting would render the operation of these rules a nullity, even though these rules are one of the key safeguards on which the Commission relied when it eliminated structural separation of BOC nonregulated activities. Without effective cost allocations, the FCC will no longer be able to rely on this safeguard in the pending *Computer III* matter. The FCC recently updated the record in *Computer III*, which has remained on remand at the FCC for many years, to determine if its existing safeguards are sufficient to protect nonregulated competitors (e.g., ISPs). *Further Comment Requested to Update and Refresh the Record on Computer III Requirements,* CC Docket Nos. 95-20, 98-10, Public Notice DA 01-620, released March 7, 2001.

There is no dispute that all of these regulatory regimes remain necessary and important, nor is there any dispute that the Commission and state commissions need adequate cost information to implement and enforce these various sets of rules. Without the availability of nationally uniform Class A accounts that are readily adaptable to any context, however, regulators will be forced to reinvent the wheel in each proceeding, and subpoena or otherwise obtain the necessary LEC data in each specific context. Putting aside the administrative burdens of such an *ad hoc* approach – which would be quite substantial – reinventing the wheel in each proceeding is *not* an adequate substitute for the availability of nationally uniform Class A accounts. The need to compare quarterly results within one company's data, and to benchmark that data to other carriers' results, is usually essential to decide whether any individual data point is a reasonable one. In virtually all cases, it is the ability to compare company-specific results (study area by study area) over time to the results of other Class A companies that gives regulators the ability to decide if a problem exists that is worth further investigation. It is far more efficient to collect the data points routinely that are commonly needed, so that they are available for instant analysis and referral.[6]

The *only* argument in favor of repealing all or part of Class A accounting is that it would be more convenient for the incumbent LECs. That concern is a makeweight. The incumbents admitted in their comments that they already keep internal accounts that are more detailed than Class A, and their own experts estimated that the complete repeal of Class A accounting would produce cost savings that are negligible. *See* USTA Comments at 6 (repeal of Class A accounting would save the LECs $2 million annually); AT&T Reply Comments at 8 (collecting cites). The notion that repealing these rules is necessary to permit these dominant carriers to respond more effectively to competitive entry borders on ludicrous. The only effect of repeal would be to deprive *regulators* of the information they need to maintain and enforce their rules. The continuing need for this information would simply force regulators to rely on *ad hoc* requests for information, which ironically, would inevitably increase the incumbent LECs' cost of compliance relative to the current system.

Respectfully submitted,

[6] *In the Matters of 1998 Biennial Regulatory Review – Review of ARMIS Reporting Requirements*, Report and Order, 14 FCC Rcd. 11443, ¶ 22 (June 30, 1999) ("*ARMIS Reporting Requirements Report*") ("[W]e are not persuaded at this time by ILECs' claims that the requisite financial detail could be provided on an as-needed basis instead of an annual ARMIS filing. One objective of the Uniform System of Accounts is to maintain a sufficiently detailed and current regulatory accounting-based system that facilitates recurrent regulatory decisionmaking without undue delay or reliance on *ad hoc* information requests and special studies. Without annual filings, the Commission, state regulators, and the public would not have access to the information contained in the complete ARMIS database. In addition, maintaining the ARMIS database, accessible on the Internet, will increase the public's access to the Commission's information. Providing financial data on demand may suffice for a specific analysis, but it would not provide the financial and operating data to administer accounting, cost allocation, jurisdictional separations, and access charge rules, and it would not preserve the Commission's ability to monitor industry developments and quantify the effects of alternative regulatory proposals. Moreover, this proposal would not permit state regulators or other parties to use the ARMIS data for their purposes. We, thus, reject this proposal to eliminate our ARMIS reporting requirements.").

cc: Dorothy Attwood
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